

## **EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE**

### **MINUTES OF THE FEBRUARY 18, 2009 ANNUAL PENSION BOARD MEETING**

1. Call to Order

Chairman Dean Roepke called the meeting to order at 9:30 a.m. in the Zoofari Conference Center at 9715 Bluemound Road, Milwaukee, Wisconsin 53226.

2. Roll Call

Members Present:

Linda Bedford (Vice Chair)  
Donald Cohen  
Mickey Maier  
Marilyn Mayr  
Jeffrey Mawicke  
Dr. Sarah Peck  
Dr. Dean Roepke (Chairman)

Members Excused:

Roy Felber

Others Present:

Lee Holloway, Chairman, Milwaukee County Board of Supervisors  
David Arena, Director of Employee Benefits, Department of Administrative Services  
Mark Grady, Principal Assistant Corporation Counsel  
Dale Yerkes, Assistant to the Fiscal Officer  
Sushil Pillai, Milwaukee County Program Manager  
Steven Huff, Reinhart Boerner Van Deuren s.c.  
Ed Mooney, Artisan Partners  
Floyd Dukes, Artisan Partners  
Brett Christenson, Marquette Associates, Inc.  
Cliff VanBeek, Prior Pension Board member  
Bruce Richardson, Prior Pension Board member  
Esther Hussey, Prior Pension Board member  
Ken Loeffel, Remco Rambler editor  
Steve Schultze, Reporter, *Milwaukee Journal Sentinel*  
Milwaukee County Retirees and other attendees

3. Chairman's and Benefit Director's Report

The Chairman welcomed all those attending the annual Pension Board meeting. He stated that the meeting agenda and additional handouts are available.

Chairman Roepke introduced Lee Holloway, Chairman of the Milwaukee County Board of Supervisors. Chairman Holloway was warmly received by those in attendance.

Chairman Holloway spoke about ERS and the role of the Pension Board. He answered a variety of questions from the audience. Chairman Holloway thanked all in attendance for inviting him to the meeting.

Chairman Roepke introduced David Arena, Director of Employee Benefits for Milwaukee County. Mr. Arena discussed the 2008 accomplishments of the Pension Board and the accomplishments of the ERS Retirement Office. He reported that ERS ended 2008 with approximately \$1.2 billion in assets. He stated that ERS is a mature plan with more retirees (7,400) than active employees (5,000).

Mr. Arena presented ERS's investment highlights for 2008. He reported that ERS performed in the top quartile of funds with greater than \$1 billion in assets (included in the Wilshire Cooperative Universe) for 2008 and over the past ten-year time period. He indicated that the Pension Board replaced its mid-cap value equity investment manager with Artisan Partners, who will be presenting today. He noted that ERS agreed to invest \$30 million over a period of four years with Adams Street Partners, ERS's private equity manager. He commented that ERS's real estate manager was granted authority to invest globally in order to better seek out investment opportunities for ERS. He pointed out that the Pension Board generally meets with one of its investment managers at each monthly Pension Board meeting as part of its ongoing evaluation and due diligence.

Mr. Arena reviewed the accomplishments of the ERS Retirement Office, which is responsible for the day-to-day ERS operations. He reported that ERS continues to receive good reports from the annual external audit of ERS. He indicated that ERS centralized its open records request processing system, which has increased the transparency of ERS. He noted that ERS recently implemented online voting for Pension Board representatives. He stated that online voting increased voter participation, costs less than in-person voting and is quicker and more efficient. He pointed out that ERS successfully issued three requests for proposals in 2008, for investment custodian services, investment consulting services and fiduciary liability insurance. He indicated that the request for proposal process will result in substantial cost savings to ERS. He noted that the Retirement Office copied to DVD all of the Pension Board meeting minutes dating back to 1938.

Mr. Arena discussed the implementation of the new pension computer system. He indicated that the County wanted to eliminate its mainframe computer system to reduce ongoing costs, which forced ERS to procure a new pension system. He reported that the new system, named the V3 System, went live in January and is the second largest computer system conversion in Milwaukee County history. He noted that the V3 System is web-based and remotely warehoused. He stated that the implementation went smoothly and that the Retirement Office is correcting the isolated problems associated with the first batch of checks run by the V3 System.

Mr. Arena stated that the Retirement Office is digitally copying all of the records to make them better accessible. He indicated that 1.5 million records will be transferred to offsite storage. He noted that there is still three years worth of records to copy.

Mr. Arena noted that the Retirement Office is in the process of creating a procedures manual, which codifies all written procedures that the Retirement Office follows. He commented that the Retirement Office has also created a centralized legal opinion file and pointed out that legal opinions help clarify how ERS should be administered. He stated that the Retirement Office is focused on providing employees, beneficiaries and retirees with a higher level of customer service.

In response to a question, Mr. Pillai stated that the self-service component of the V3 System will allow an ERS member or retiree to view his or her personal data and related major documents. In response to a question, Mr. Arena stated that the Retirement Office has focused on providing better phone service, including the creation of a toll-free telephone number, and noted that the Retirement Office is trying to catch up after answering all of the questions generated by implementation of the V3 system.

Mr. Arena reviewed ERS's quality assurance and customer service measures. He indicated that Retirement Office employees have undergone enhanced customer service training. He reported that the Retirement Office recently began holding preretirement information seminars. He pointed out that the Retirement Office has implemented several items that will help members and retirees, including the toll-free information line and a series of informational brochures. He stated that more information will be available on the Intranet with the V3 System.

Mr. Arena reported that the Retirement Office is constantly reviewing information to ensure accuracy. He indicated that the Retirement Office is trying to become more automated by reducing the number of paper forms and documents. He commented that all of the current employees, retirees and beneficiaries will see the benefits of the V3 System. He noted that all of the Retirement Office staff went through intensive online training on the V3 System in order to better serve ERS members and retirees. He pointed out that the training will also improve accuracy, which is another focus of the Retirement Office. He stated that ERS distributes approximately \$135 million in benefit payments each year and must be careful to avoid mistakes. He noted that the V3 System has increased security measures and includes several features that will allow the Retirement Office to perform more thorough audits.

4. ERS Fund Results and Update – Brett Christenson, Marquette Associates, Inc.

Mr. Arena introduced Brett Christenson, managing director of Marquette Associates, Inc., ERS's new investment consultant. Mr. Christenson stated that he will be discussing ERS's performance in the fourth quarter of 2008 and for all of 2008. He indicated that ERS had approximately \$1.195 billion in assets at the end of 2008. He noted that ERS

had approximately \$1.6 billion in assets at the beginning of 2008. He attributed the decrease in ERS's assets primarily to the decrease in the U.S. equity market, as evidenced by the S&P 500 being down 37% in 2008. He reported that ERS is managed conservatively and has the liquidity to continue paying benefits.

Mr. Christenson reviewed ERS's actual asset allocation compared to its target allocation at the end of 2008. He reported that ERS had 50% of its assets in bonds managed by four fixed income managers, compared to the 42% target for fixed income. He stated that ERS's asset allocation is conservative. He indicated that ERS was well diversified in U.S. equities with 26.2% of its assets in this class compared to the target of 32%. He noted that ERS was underweight in U.S. equities and international equities because of the market losses. He stated that ERS's allocation to international equities is 14.1% compared to its 20% target. He commented that ERS is currently weighing its various asset allocation options and wants to remain conservative, while at the same time increase investment returns. He pointed out that ERS is invested in bonds and maintaining \$50 million in cash for liquidity due to the volatility of the market.

Mr. Christenson compared ERS's asset allocation to its peer groups, which are all public pension funds and all pension funds (public and nonpublic) with greater than \$1 billion in assets contained in the Wilshire Cooperative Universe. He reported that ERS is invested more conservatively than both of its peer groups, being below its peers with respect to ERS's allocation to equities and above its peers with respect to ERS's allocation to fixed income.

Mr. Christenson indicated that ERS performed in the top quartile compared to all funds with greater than \$1 billion in assets for 2008 and the ten year time period ending on December 31, 2008. He commented that ERS has benefited from its conservative asset allocation in 2008. He stated that ERS needs to continue to look for ways to minimize volatility while achieving or exceeding its 8% actuarial rate of return. He pointed out that ERS lost 22.1% of its value in 2008, when it needed to earn 8% to meet its actuarial rate of return.

Mr. Christenson reviewed ERS's investment returns over the past ten years. He indicated that ERS had three years of negative returns from 2000 through 2002 during the last bear market. He noted that ERS had strong returns in 2003 and 2004 when the bear market recovered. He stated that the market needs to stop its negative feedback cycle in order to discover stable ground and begin recovering.

Mr. Christenson reviewed the performance of each of ERS's investment managers against their benchmarks. He commented that the Pension Board is diligent in hiring and retaining managers that outperform their benchmarks. He stated that the Pension Board decides when to replace investment managers. He indicated that Loomis Sayles, one of ERS's three core fixed income managers, performed significantly below its benchmark. He stated that there have been no defaults in Loomis's portfolio and the negative

performance was due to pricing pressure, but commented that Loomis has a strong portfolio and will make back its losses when the bonds it holds are sold at par value. He commented that Loomis also manages a high-yield fixed income strategy for ERS, which invests primarily in junk bonds. He stated that junk bonds typically track the performance of the equity market and he hopes to see a rebound in this area, after seeing 6% gains in high-yield fixed income in December and January.

Mr. Christenson reported that ERS's large cap value equity manager, Boston Partners, held up relatively well in 2008, losing 33.1% compared to the benchmark's loss of 36.9%. He stated that ERS's mid-cap core equity managers, Reinhart Partners and EARNEST Partners, both slightly beat their benchmark, but Marquette will continue to monitor these asset manager classes. He commented that ERS does a good job at diversifying its assets, as indicated by ERS having multiple managers for certain asset classes, such as international large cap equity. He stated that it is a sign of a bad market when GMO, ERS's international large cap value equity manager loses 38.7% for 2008 and ranks in the top 1% of best performing asset managers in its class.

Mr. Christenson stated that ERS is very diversified in domestic equities, international equities and fixed income. He explained that there was "nowhere to hide" in the markets in 2008 to avoid losses. He pointed out that most of ERS's investment managers beat their benchmarks, while only a few performed below their benchmarks.

In response to a question, Mr. Christenson stated that it was Marquette's recommendation to participate in a cash overlay program for funds received from the issuance of pension obligation bonds. He explained that ERS would not want to immediately invest all of the money only to have to reallocate the funds, which would greatly increase the transaction costs. He discussed how under the cash overlay program ERS would invest the money ratably over a five month period to achieve dollar cost averaging and to minimize exposure to daily event risk. He reported that ERS would purchase futures in the S&P 500 index, fixed income and international equities in accordance with ERS's current asset allocation. He commented that the cash overlay program is the cheapest and most popular method to replicate the returns ERS would achieve in the market. He noted that futures have been used for over 100 years, and the futures to be used would not be leveraged.

In response to a question, Mr. Christenson stated that the school districts who lost money invested in credit default bonds, which is not what ERS would invest in through the cash overlay program. He noted that a cash overlay program is a very common and conservative practice, and will allow the Pension Board to invest the pension obligation funds prudently and inexpensively. He indicated that ERS will avoid brokerage costs of making direct investments until the Pension Board makes permanent decisions on investment allocations.

In response to a question, Mr. Christenson opined that there will be much better transparency in the markets and a reduction in leverage in response to the market failures. He pointed out that the experts' investment models did not work in the current market. In response to a question, Mr. Christenson stated that the Pension Board always looks at using Milwaukee based investment managers and provided the example of the Pension Board choosing Artisan Partners, located in Milwaukee, to manage its mid-cap growth strategy. He stated that the Pension Board hires investment managers to act as fiduciaries with full discretion to manage a portion of ERS's assets. He indicated that the Pension Board, with the assistance of Marquette, performs due diligence to make sure that the managers can process market information prudently and can diligently sort and process investment information.

5. Artisan Partners

Ed Mooney and Floyd Dukes introduced themselves and stated that they will be presenting on behalf of Artisan Partners. Mr. Mooney stated that Artisan Partners is a Milwaukee-based investment management firm that was founded in 1994. He noted that Artisan Partners has offices in Atlanta and San Francisco, in addition to its Milwaukee headquarters, where 70% of Artisan Partners' employees work. He indicated that Artisan Partners has approximately \$30 billion in assets under management and a majority of its clients are pension plans like ERS. He commented that mid-cap strategies comprise about one-third of Artisan Partners' operations. He opined that mid-cap stocks are more focused and provide a better risk/reward to the investor than other classes of equities.

Mr. Dukes introduced himself and stated that he manages the mid-cap value strategy in Atlanta. He noted that the mid-cap growth style is managed in Milwaukee. He indicated that Artisan Partners has managed ERS's growth strategy since June 2008 and ERS's value strategy since June 2000. He commented that 2008 was a difficult year for all asset classes. He explained that mid-cap companies are companies with between \$1 billion and \$10 billion in overall market value, and small cap companies are under \$1 billion in market value, while large cap companies are companies with greater than \$10 billion in market value. He provided an example of each type of company.

Mr. Dukes reviewed the strategy and outlook for the mid-cap market sector. He stated that the housing crisis had far-reaching effects. He indicated that the foreclosure rate was at 3% at the end of 2008, compared to approximately 1% in 2007. He commented that homes are generally the largest item on a person's balance sheet. He stated that the primary effect of a home decreasing in value is that a person does not feel as wealthy and will not spend as much as they have in the past. He noted that the less apparent secondary effect is the decline in the value of collateral is causing banks not to make loans. He pointed out that the secondary effect is making it tougher for companies to finance their operations.

Mr. Dukes stated that the current unemployment rate is between 7% and 7-1/2%, which is a significant increase compared to the 2004 levels. He noted that the unemployment level has been at this point before, and the current unemployment rate is not nearly as high as the unemployment rate of the early 1980's. He indicated that unemployment has a significant effect on mid-cap stocks and unemployment results from consumer inactivity. He opined that the economy has been through rough times before and Artisan Partners is confident that the market will recover, although the recovery might be choppy.

Mr. Dukes reviewed the trends in consumer confidence and the savings rate. He indicated that the biggest negative change in consumer confidence came in October and November 2008 as a result of the bad economic news. He stated that over \$1 trillion was removed from the equity market into safer investments. He noted that fear, uncertainty and lack of confidence caused artificially low stock prices and investors to flee the market. He commented that the uninvested money will eventually return to the market and reverse the negative trends. He pointed out that the savings rates are increasing. He stated that consumer spending will grow when the market stabilizes.

Mr. Dukes opined that the future of the mid-cap stocks looks promising based on the interest rate and inflation environment. He indicated that inflation has declined to a level of almost being nonexistent. He estimated that lower gas prices have resulted in approximately \$300 to \$400 billion in savings. He reported that mortgage interest rates have declined and should stay fairly low, which will result in a stimulus for the housing market. He commented on how creative financing and risky mortgages are virtually gone from the market.

Mr. Dukes provided an outlook on the markets. He stated that he anticipates continued volatility in the markets. He noted that most of the bad news is behind us, but acknowledged that the real question behind the timing of a recovery is dependent upon the return to stability for the automotive and financial services industries. He opined that mid-cap companies will continue to offer a good risk/reward profile. He commented that the decline in home prices and the value of the stock market decreased individual wealth, but he expressed his belief that the cycle of wealth creation over the long term should return.

Mr. Dukes stated that this is the best time within the last five to seven years to purchase stock in companies. He reported that dividend and cash flow yields have increased to levels not seen since the early 1990s. He indicated that valuations of companies are as attractive as they have been in the past ten years. He stated that the next three to five years is a good opportunity to make money by investing in companies with great business models, products and management teams. He indicated that mid-cap companies are positioned well and that Artisan Partners is building positions in good companies, but acknowledged that there are risks.

Mr. Dukes fielded questions from the audience on various topics.

6. Marquette Associates, Inc.

Mr. Christenson presented a review of ERS's asset allocation. He compared ERS's investment performance for each of the past ten years against ERS's actuarial rate of return of 8%. He indicated that ERS must beat its hurdle rate of 8% each year, and that ERS underperformed the hurdle rate by 30% in 2008. He stated that ERS's goal is to achieve more consistent investment returns through its asset allocation.

Mr. Christenson explained that it is impossible, even for experts, to predict or anticipate bear market downturns of 20% in the equity market. He discussed how pension plan fiduciaries invest based on a long-term basis, 10 to 30 years, focusing on when the benefits will need to be paid. He stated that research shows that asset allocation drives 91.5% of investment returns. He commented that the objective is to choose asset classes and focus on how they work together in order to achieve consistent returns.

Mr. Christenson explained that even though ERS was diversified in 2008, diversification does not work when the market is in distress. He stated that plans should focus more on choosing asset classes that hold up better in bad markets. He commented that ERS needs to look at asset classes that provide more income and provide more diversification. He noted that investments in private real estate, infrastructure and the long/short equity investment strategies lose less when the market goes down.

Mr. Christenson pointed out that over the past ten years, only three asset classes outperformed ERS's 8% actuarial rate of return. He commented that ERS already has good balance and Marquette's overall goal is to change ERS's target asset allocation to reduce the risk of underperforming the actuarial rate of return, while possibly increasing investment returns.

7. Question and Answer Session

In response to a question, Mr. Christenson stated that investors cannot predict the downturns in the market. In response to a question regarding why the market continues to fall despite the inflow of the stimulus money, Mr. Christenson explained that the market will not significantly respond in a positive manner until investors have clarity on the finance and automotive industries. Mr. Christenson commented that investors are scared and the money will not return to the market until investors understand the situation more clearly. In response to a question, the Chairman stated that ERS did not have much exposure to Lehman Brothers.

In response to a question regarding the V-3 System, Mr. Arena stated that he expects the self-service function of the V-3 System to be operational by the end of the second quarter. He indicated that ERS retirees and members will be kept informed of any updates through various ways, including the *Communicator* newsletter. In response to a question regarding the security of the V-3 System, Mr. Arena stated that the V-3 System



server is located in a secure facility in New Jersey, which he visited, and the server is backed up at several other secure locations located throughout the United States.

In response to a question regarding the Mercer lawsuit, the Chairman reported that the trial is scheduled for May 2009.

8. Adjournment

The meeting adjourned at 12:10 p.m.

Submitted by Steven D. Huff,  
Secretary of the Pension Board